

Internal Revenue Service

Number: **200718002**

Release Date: 5/4/2007

Index Number: 141.00-00, 103.02-02

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:TEGE:EOEG:TEB

PLR-103681-07

Date:

January 29, 2007

LEGEND

System

County

State

Medical Center

Bonds

County Board

Act

Date

Year 1

Year 2

Year 3

a

b

c

d

e

f

Dear

This is in response to the request for rulings that System is an instrumentality of County and a constituted authority empowered to issue bonds described in § 103 of the Internal Revenue Code (the “Code”) on behalf of County.

FACTS AND REPRESENTATIONS

County, a political subdivision of State, owns and operates the Medical Center, a large, public, teaching hospital. A portion of the Medical Center has been refinanced with the Bonds issued by County.

In Year 1, the County Board appointed a task force to evaluate the operation of the Medical Center in a changing health care environment while yet preserving its public mission. As a result of the recommendations of the task force and pursuant to State legislative authority (*i.e.*, the Act), the County Board created System as a public corporation that will operate as a subsidiary of County to provide health care and related services to the general public and related education and research programs. The County Board has filed a certificate of approval giving effect to certain provisions of the Act. As required by the Act, County has approved System’s initial bylaws.

System has only one member, County. System will be governed by a board of directors (the “System Board”) of between *a* and *b* directors, two of which must be County commissioners. The two directors that are County commissioners are chosen, and may be removed, by a majority vote of the County Board. The chief executive officer of the System will be an *ex officio* director. The initial System Board (other than the County commissioners) was appointed by the County Board. Upon expiration of the terms of these directors, the County Board will appoint directors (other than the County commissioners and chief executive officer) by slate for staggered 3-year terms. The slates will be nominated by a committee of the System Board. The System Board may appoint directors to fill unexpired terms; however, such directors must be submitted to the County Board for approval when the next slate is submitted. A System director that is not a County commissioner may be removed without cause by a two-thirds majority

vote of the System Board. The County Board may remove a System Board director that is a County commissioner, may remove other directors for cause, and with a two-thirds vote of the entire County Board, may remove the entire System Board for County to resume management of the Medical Center. The directors other than the chief executive officer will serve without compensation.

System must submit to the County Board for review and approval a health services plan, including education, research, and services to improve the health of the community. System is required to provide its services to persons who are indigent. In addition, the County Board retains the authority to require System to provide health care or related services as the County Board determines to be in the best interests of County, to be paid at County's expense. System also must submit to the County Board its annual capital and operating budgets for approval and an annual audited financial statement. The County Board's authority over System's budget and expenditures includes review and approval of capital expenditure budget line items when those items exceed stated threshold percentages and approval of capital expenditures that exceed the amounts approved in the budget. The County Board also must approve any debt incurred by System other than that defined in the bylaws as *de minimis* debt.

Effective on Date, County has leased the real property used by the Medical Center to System for \$1 per year and contributed the other tangible and intangible assets used exclusively by the Medical Center to System. County also has entered into an operating and funding agreement with an initial term of *c* years to provide System with (1) payments, projected to be \$*d* million in Year 2, equal to *e* percent of System's actual average Medical Assistance reimbursement rates for uncompensated care provided to residents of County in excess of the average level of uncompensated care provided by the other hospitals in County, (2) one or more capital infusions, if necessary, to ensure System has sufficient working capital, and (3) \$*f* million for capital improvement projects approved through County's budgeting process during the period of Year 2 through Year 3. County intends to issue general obligation bonds to fund these capital improvement projects. The Act generally considers System as a municipality for purposes of bond issuance; however it limits System's authority to the issuance of revenue bonds for its corporate purposes, subject to the County's reserved powers. Security for System's bonds is restricted to System's pledge of its interests in property and its revenues.

System may not transfer or dispose of substantially all of its assets without approval by the County Board. Upon dissolution of the System, its net assets must be distributed to County for public purposes. No part of the net earnings and assets of System may inure to the benefit of any private individual, nor may any part of the income or assets of System be distributed to or divided among any private individuals as dividends or otherwise.

System is exempt from State income, corporate franchise, and general sales and use taxes. Interest on any bonds to be issued by System will be exempt from State personal income taxation if such interest is excludable for Federal income tax purposes.

LAW AND ANALYSIS

Instrumentality Status of System

Section 103(a) provides, in general, that gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141). Section 141(a) defines private activity bond to mean any bond issued as part of an issue which meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2), or which meets the private loan financing test of § 141(c).

An issue meets the private business use test of § 141(b)(1) if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(6) defines private business use as use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. Section 1.141-3(a)(1) of the Income Tax Regulations provides that the 10 percent private business test of § 141(b)(1) is met if more than 10 percent of the proceeds of an issue is used in a trade or business of a nongovernmental person. Section 1.141-1(b) defines a nongovernmental person as a person other than a governmental person. A governmental person means a state or local governmental unit as defined in §1.103-1 or any instrumentality thereof.

Revenue Ruling 57-128, 1957-1 C.B. 311, sets forth the following factors to be taken into account in determining whether an entity is an instrumentality of one or more governmental units: (1) whether the organization is used for a governmental purpose and performs a governmental function; (2) whether performance of its function is on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved, or whether the states or political subdivisions have the power and interests of an owner; (4) whether control and supervision of the organization is vested in a public authority or authorities; (5) whether express or implied statutory or other authority is necessary for the creation and/or use of the organization, and whether this authority exists; and (6) the degree of financial autonomy of the entity and the source of its operating expenses.

System will operate Medical Center and provide health care services, including indigent care, and education to the general public. It must provide such services as determined by the County Board to be in the best interests of County. Thus, System is used for a governmental purpose and performs a governmental function on behalf of County, a political subdivision. The sole member of System is County, and upon dissolution of System, its assets will be distributed to County for public purposes. Accordingly, County has the power and interests of an owner of System and there are no private

interests. The County Board appoints the directors serving on the System Board (with the exception of the chief executive officer of System) and may remove the directors. The County Board must approve System's health service plan and its annual budgets for capital and operating expenses. In addition, the County Board must approve budget line items for capital expenditures above certain thresholds and expenditures that exceed the budgeted amounts, and must approve debt to be incurred by System above that defined as *de minimis* debt. Thus, control and supervision of System are vested in County, and System's financial autonomy is limited by County. The Act provides the statutory authority to create System. Last, County has leased the Medical Center to System for \$1 per year, will reimburse System for certain uncompensated care, and will provide operating funds to System as needed.

Considering the factors of Rev. Rul. 57-128 as applied to the facts and representations of this ruling, we conclude that System is an instrumentality of County and, therefore, a governmental person for purposes of § 141.

On Behalf of Issuer

Section 103(c)(1) defines a "state or local bond" for purposes of §§ 103, and 141 through 150 as an obligation of a state or political subdivision thereof. Section 1.103-1(a) provides, in part, that interest upon obligations of a state, territory, a possession of the United States, the District of Columbia, or any political subdivision thereof (hereinafter collectively or individually called "state or local government unit") is not includable in gross income. Section 1.103-1(b) provides, in part, that an obligation issued by or on behalf of any governmental unit by a constituted authority empowered to issue such an obligation is the obligation of such a unit.

Revenue Ruling 57-187, 1957-1 C.B. 65, holds that bonds issued by an industrial development board formed under a state statute (the "entity") are considered issued on behalf of a political subdivision of the state under the following conditions: (1) the entity is formed only after the governing body of the political subdivision has formally approved the entity's creation and the form of certificate of incorporation; (2) a board of directors of the entity is elected by the governing body of the political subdivision and serves without compensation; (3) the entity may issue bonds to carry out any of its corporate powers, which include the power to acquire, improve, maintain, equip, and furnish projects, to lease such projects and collect rent, and to sell and convey any and all of its property whenever the board of directors find such action to be in furtherance of the purposes for which the entity is established; (4) all bonds are payable solely out of revenues and receipts derived from the leasing or sale by the entity of its projects; (5) the political subdivision is not liable for the payment of principal or interest on any of the bonds of the entity; (6) the entity is exempt from all taxation, and interest on bonds issued by the entity is exempt from state taxes; (7) the entity is a nonprofit organization and none of its net earnings may inure to the benefit of any private person; and (8) upon dissolution of the entity, title to all property it owns would vest in and become the

property of the state or political subdivision which creates it.

The facts of this ruling are similar to those of Rev. Rul. 57-187. Therefore, we conclude that System will qualify as a constituted authority eligible to issue bonds on behalf of County.

CONCLUSIONS

We conclude that:

1. System is an instrumentality of County and; therefore, a governmental person for purposes of § 141; and
2. System is a constituted authority eligible to issue bonds on behalf of County.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your representative.

Sincerely,

Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Government Entities)

By: Johanna Som de Cerff
Senior Technician Reviewer
Tax Exempt Bond Branch